

1998

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Recommended Citation

Jorge Hugo Asain, *Financing of Real Estate Projects in Argentina*, 4 LAW & BUS. REV. AM. 96 (1998)
<https://scholar.smu.edu/lbra/vol4/iss1/7>

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Financing of Real Estate Projects in Argentina

*Jorge Hugo Asiain**

I. Introduction.

Economic growth is a goal of any country. However, a series of macroeconomic circumstances must take place to make economic growth possible. Construction activities are considered to be an essential driver of such growth and the macroeconomic circumstances seem to converge in that sense. These activities, as any other activity, require clear game rules that are essential for this type of activity. Investments generate capital lock-ups in the medium term which require currency stability and reliability to access financing sources.

Argentina has developed a fiscal policy that favors financial activities, and has gone even deeper into such policy with the latest rules issued on that particular subject.

Local investors enjoy a comprehensive menu of financial transactions exempt from the income tax with certain exceptions such as the inclusion of taxed property in the personal property tax.

Foreign investors enjoy a highly beneficial taxation, as they are exempt from paying the personal property tax.

The enactment of Act Number 24.441 of Financing of Housing and Construction has closed the cycle of the construction financing business.¹ As we will see, the main causes that previously made these operations difficult have been overcome.

II. Traditional Financing.

A. LOCAL FINANCING.

Financing is granted by financial institutions through the so-called mortgage loans. Taxation relating to this transaction is as follows:

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1. Law No. 24.441, Jan. 16, 1995, B.O. (Arg.).

Income Tax: There is no special taxation applicable to this financing which is liable to this tax, together with income from other sources, at a 33 percent rate.

Value Added Tax: Income from loans for purchase, improvements or construction of dwelling houses are exempt.²

Turnover Tax: Financial entities are taxed at a 4.9 percent rate.

Tax on Assets: This tax has been repealed for fiscal years ended as of June 30, 1995.

B. FOREIGN FINANCING.

Income Tax: Interest is covered by the tax because it is a transaction considered to be of Argentinean source for an overseas beneficiary.³ The tax is paid through a withholding which as a single and final payment must be made by the local borrower or the involved lending entity, being the effective rate 13.2 percent.⁴ If the lender is a resident of any country with which Argentina has signed a treaty to avoid international double taxation, it may obtain a lower withholding rate in some instances. Treaties currently in force are as follows: Germany: if the loan is granted by a bank, the tax rate is 10 percent; Austria: 12.5 percent; Canada: 12.5 percent; Spain: 12.5 percent; and Sweden: 12.5 percent. In the event that the local borrower pays the tax, he should make the appropriate grossing-up of the tax so the overseas beneficiary earns interest free of withholdings. In such cases, the general rate goes up to 15.21 percent except when the loan is granted directly to the construction company and the grossing-up is not applied.⁵

Value Added Tax: The transaction is objectively liable to the tax because it takes place in Argentina. Notwithstanding, a non-resident subject is not liable to this tax.

Turnover Tax: Not taxed for the above mentioned reasons.

Personal Property Tax: Companies are not taxed. Individuals are taxed at the general 0.5 percent rate. The tax is paid by the substitute, responsible borrower of the loan.⁶

C. SECURITIZATION. INVESTMENT TRUSTS.

Act 24.441 introduced, among other things, the system that regulates the operation of the so-called securitization of mortgage loans. This securitization is a special type of trust derived from the general trust system.

Section 19 of the Act defines trusts as those integrated by mortgage loans transferred by the grantors (financial entities) to a trustee that can be a financial entity or a company specially authorized by the National Securities Commission to act as such. The beneficiaries are the holders of share certificates in the fiduciary ownership or debt certificates secured with the property thus transferred. In non-legal terms, investors (beneficiaries) subscribe the shares in the trust that acquires the mortgage loans of financial entities that granted such loans. The trust is managed by the above mentioned persons (trustees).

The taxes involved in the business are those already analyzed and are specifically dealt

2. Law No. 24.698, (h)16.8, Sept. 27, 1996, B.O. (Arg.).

3. Law No. 24.073, Apr. 13, 1992, B.O. (Arg.).

4. Law No. 24.698, 93(c), Sept. 27, 1996, B.O. (Arg.).

5. Regulatory Decree 150.

6. Law No. 24.441, section 26.

with in the rules contained in the Act.⁷ The analysis should be made with respect to the involved taxes and those involved in the business considering their different roles. The aim of the rules that were passed is to overcome any difficulty related to tax aspects that might interfere with the development of the financial market for this business.

D. VALUE ADDED TAX.

A point of vital importance that previously inhibited the development of the financial market involves the Value Added Tax taxation of interest generated by the assignment of mortgage credits. Decree 2633/92 defined the tax base of credit assignment and/or document discount transactions as follows:

For the purposes provided for in section 9 of the act, in the case of purchase and discount transactions by endorsement or assignment of promissory notes, bills, pledges, commercial papers, mutua, invoices, etc. the tax base shall be that resulting from the difference between the final credit value and the amount paid by the purchaser.

For that purpose, if there was no interest breakdown, the final credit value shall be the one included in the negotiated instrument.

Should interests be broken down, these shall be added to the above mentioned value and when they are not determined, the calculation thereof shall be finally made based upon the relevant variables at the time either the endorsement or assignment takes place. Obviously, this made transactions with third parties other than financial entities impossible.⁸ If interest, whether accrued through the end of the credit, is to be added to the difference between the nominal value of the assigned credit and the amount paid by the assignee, and on top of that the tax is to be added. This generates a fictitious tax at an inappropriate time.

To solve that problem, the first paragraph of section 84, Act 24.441 stated the following: for value added tax purposes, when the assets held in trust are credits, transfers in favor of the trust shall not constitute taxed financial services or placements.

Another matter that had to be solved pragmatically was derived from the issue of assigned credits including financing interests on the original transaction. These assigned credits are financial charges originating in the credit transaction made by the assignor with third parties.⁹ The second paragraph of the above mentioned section states the following: when the assigned credit includes financing interests, the passive subject of the tax for the service corresponding to such interests shall continue to be the trustor unless payment should be

7. *Id.* at Title XII, Chapter 1, sections 83 and 84, and Decree 780/95, Title II, Chapter 1, sections 10, 11, 12, 13, and 14.

8. The BCRA (Central Bank of the Argentine Republic) made clear through Communication "A" 2322 (Official Bulletin, Apr. 11, 1995) that it is considered that the other loans between financial entities --tax exempt according to section 7, subsection (h), paragraph 16, subparagraph 1 of the Act -- included the financing agreed upon between such intermediaries regardless of the conditions and terms thereof, including all portfolio assignments with or without liability for the assignor.

9. This situation takes place when credits other than home mortgage loans are involved because, as we have already seen, they are exempt. Law No. 24.441, section 7, subsection (h), paragraph 16, subparagraph 8, B.O. (Arg.).

made to the assignee or the person appointed by him, and in that case, the individual that receives it shall become the passive subject.¹⁰ At the request of the financial institutions that were overburdened as subjects liable to the tax, this definition of the rule was amended by General Resolution Number 3827 which in paragraph I therein states the following:

When in a purchase or discount transaction by way of endorsement or assignment of documents such as promissory notes, bills, pledges, commercial papers, mutua, invoices, etc. including financing interests, a financial entity subject to the system provided for in Act 21.526 acts as assignor or assignee and the assignor, or as applicable, the manager or agent receiving the portfolio appointed for that purpose is a subject domiciled in the country which acts formally as collection agent of the negotiated documents, the provisions of section two added after section 7 of Decree 2407/86 which regulates the value added tax law shall not be applicable. In the business under analysis, the financial entity that transfers the credits to the trust continues to be responsible for depositing the tax upon collection or due date of the obligation to pay interests by the original borrower of the credit. Obviously, because these are home mortgage loans, the original transaction would not have taxed interest.

The trust is released from performing the obligations related to the value added tax derived from the acquired credits and also from the services generated by the management of the trust and the generated income. Sub-section (a) of section 83 states: financial transactions and services related to the issue, subscription, placement, transfer, depreciation, interest and pay-off, as well as those related to the securities thereof, are exempt from the value added tax.

E. INCOME TAX.

Another tax aspect provided for in the system in keeping with the policy followed with respect to investors in financial assets grants full exemption from the income tax for results derived from subscription of share certificates. Sub-section (b) of the above mentioned section states the following:

The results derived from the sale, exchange, barter, conversion and disposition thereof, as well as interest, restatements and capital adjustments thereof, are exempt from the income tax except for subjects covered by Title VI of the Income Tax Law. When overseas beneficiaries covered by Title V of the above mentioned regulation are involved, the provisions of section 21 thereof and section 104 of Act 11.683 shall not be applicable.

Two aspects included in such rule should be made clear. One aspect of the rule refers to the fact that the exemption is not applicable to subjects required to perform a restatement for inflation purposes, even when currently that is not in force.¹¹ Subjects required to perform the restatement for inflation purposes are those listed under sub-sections (a), (b) and (c) of Section 49 of the Act. The other aspect of the rule is the reference made to the non-application of the provisions of the sections mentioned therein. Those sections regulate

10. This conclusion is consistent with what is set forth in Decree 846/93 and the conclusion contained in D.G.I. (Tax Authority) Directive Number 385/83.

11. Act. 24.073, section 39, limited the restatement for inflation purposes considering the inflation rate of March, 1992, included, as the ceiling.

the so-called "transfer of income to overseas tax authorities." The sections state that when income exempt under the Argentinean rules is taxed in the jurisdiction of the one receiving such income who is domiciled abroad, the exemption shall be deemed to be not applicable. The income is taxed to the extent it is taxable in the country of residence of the beneficiary. The non-taxation in such jurisdiction must be proved through a rather complex procedure.¹² The system exempts it without any restriction whatsoever.

The other issue to be analyzed is the trust, given the inclusion of the trustee as liable for a debt other than his own through Decree 780/95. By way of a complex wording, financial trusts -- those by way of which the securitization of credits is performed -- are exempted from the tax. According to this procedure net income obtained in the fiscal year to be distributed in the future during the term of the trust agreement as well as those which in that period of time are applied to the realization of expenses inherent to the trust's specific activities which can be posted to any fiscal year after included therein may be deducted from the net taxable income.¹³

F. TURNOVER TAX.

Financial entities are taxed with a 4.9 percent rate in relation to interest charged on the original loan and shall deduct interest they are charged through credit acquisitions.

G. PERSONAL PROPERTY TAX.

Finally, another tax to be analyzed is the personal property tax. First of all, it should be mentioned that when other trusts are involved they are excluded from the definition of a person liable for debts other than his own which is also applicable in relation to this tax. Paragraph two of section 13 of Decree 782/95 sets forth that they will be taxed at the holders' place of business: "individuals and indivisible succession holders of certificates of share in the fiduciary ownership or of debt certificates, shall apply them to determine the tax on personal property."

Subjects residing in Argentina shall include them in the total property existing as of December 31, including interest accrued through that date. With respect to overseas subjects who pay in the tax by way of a substitute responsible, the situation is rather complex. According to the wording of section 26 of this tax law, those who manage the trust should act as substitute responsables because they are not included in the exceptions of sub-sections (a) through (e). However, based on the exception mentioned above, we will conclude that the person liable for debts other than his own is not applicable to holdings of non-resident investors.

12. General Resolution of DGI N° 1728.

13. Law No. 23.962, Section 10, B.O. (Arg.) (as amended).

The summary table included below sums up the taxation related to securitization.

RESIDENT LIABLE	RESIDENTS		NON RESIDENTS	
	INDIVIDUALS	COMPANIES	INDIVIDUALS	COMPANIES
INCOME TAX	Exempt	Taxed	Exempt	Exempt
Income Transfer of share	Not covered or exempt	Taxed	Exempt	Exempt
PERSONAL PROPERTY TAX Holdings at year end	Taxed	Not applicable	Taxed	Not covered
VALUE ADDED TAX Income Transfer of share	Exempt	Exempt	Exempt	Exempt
	Exempt	Exempt	Exempt	Exempt
TURNOVER TAX (Federal District) Income Transfer of share	Not covered	Taxed	Not taxed	Not taxed
	Not covered	Taxed	Not taxed	Not taxed

III. Real Estate Leasing.

Decree 627/96 regulates the taxation of leasing transactions included in Act 24.441, previously analyzed, with respect to securitization. Although this Decree regulates such Act, it creates a specific tax legislation aimed at paving the way for the use thereof as a financial tool. The Whereas Clauses thereof refer to the "the important role assigned to this institution to promote construction and access to real estate".

Sub-sections (a) and (b) of section 1 set forth that real estate leasing agreements shall be considered as such when the lessor is: "(a) a financial entity regulated by Act 21.526; and (b) a corporation whose exclusive object is this type of agreement." The wording of sub-section (b) raised the problem that construction for a subsequent lease is not the construction companies exclusive object. This issue was solved by Decree 873/97 eliminating the term exclusive, which it limited the use thereof.

IV. Agreements Related to Financial Transactions.

A. INCOME TAX.

To be considered a financial transaction, the agreement should have a term exceeding 10 percent of the useful life of the property, which in the case of buildings is 50 years according to the Useful Life Estimation Table for property published as an Annex to Decree 873/97. The leasing agreement should have a term exceeding 5 years.

B. LESSOR.

Recovery of the invested capital is not made on the basis of the useful life of property but based on the term of the agreement. Recovery of capital applied to such transactions shall be determined by dividing the purchase cost or value of the property that is the subject matter of the agreement - decreased by the proportion thereof contained in the price established to exercise the purchase option - by the number of rental periods specified therein. Furthermore, this cost is also determined based on the provisions of section 59 of the income tax law with respect to real estate.

This is an advance in the way this type of agreement used to be treated up to this date since the Tax Authority (DGI) required that agreements related to financial transactions be depreciated based on the useful life as in the case of agreements considered simply as Lease Agreements.¹⁴ The cost of the purchase option is determined by the difference between the cost and the capital recovered during the term of the agreement. Income is determined by the fee to be paid by the lessee and the price established upon exercising the purchase option.

C. LESSEE.

Another fiscal advantage implied by this type of agreement is that the lessee can apply the fee amounts paid to the lessor to the expense for the fiscal year. This application allows the lessee to anticipate the write-off related to the property depreciation.

14. Opinion Number 85/93; DGI Bulletin No. 484-469.

V. Agreements Related to Lease Transactions.

Agreements related to lease transactions incorporates in a residual manner agreements that do not meet the requirements of those related to financial transactions as far as the term thereof is concerned.

A. INCOME TAX.

1. Lessor.

The lessor should depreciate the property based on the years of useful life not on the term of the agreement. The cost of the purchase option will be determined by the property's residual value net of common depreciations.

2. Lessee.

The lessee's situation is similar to one mentioned above because the lessee will consider the value of accrued fees as a loss.

B. VALUE ADDED TAX.

Since the transaction is considered a real estate lease, it is expressly tax-exempted.¹⁵ Such a transaction is deemed to be such even when the true nature of the transaction is a sale transaction. This is the assumption included in section 5, sub-section e, paragraph 3 of the law.

Interests are tax exempt in the case of home loans.¹⁶ With respect to this expression, as expressed in the case of a lease back, it must be interpreted that in a real estate leasing, the fee must be broken down into capital and interest as required by the B.C.R.A. rules and value added tax must be applied on interests, when these are not tax exempt, such as those allocated to home loans.

C. TURNOVER TAX.

Financial entities are liable to a 4.9 percent rate on the difference between the fees and the cost of acquisition, being write-offs made on the basis of the term periods of the agreement. Other subjects' total income is liable to the general rate in force in each jurisdiction. The construction activity is exempt in some jurisdictions as in the case of the city of Buenos Aires.

VI. Lease Back.

Decree 873/67 introduced this transaction to the system provided for in decree 672/96 with the status of financial transaction: "leasing agreements entered into between the lessors included in sub-sections (a) or (b) of section 1 of this decree, whose object is real estate owned by them and purchased for that purpose from the lessees thereof, shall be related to leasing transactions."

15. Decree No. 873/67, Section 7, subsection (b), item 22.

16. *Id.* at section 11.

The same taxation system described above shall apply thereto with some unique features that are listed below. The lessees who transfer the property to the financial entity for subsequent leasing thereof may choose to post the income from the transfer to the lessor to the fiscal period when it is made or apply it to the cost of the property re-bought upon exercising the purchase option. The lessee will send to losses the financial cost included in the rental payments. The principal will be sent to losses through depreciation.

With respect to the Value Added Tax, a unique feature of real estate transactions should be mentioned. When a subject disposes of real estate for which fiscal credit was applied at the time of incorporation thereof to the company, it shall reimburse such credit within 10 years of the purchase thereof, paying in an equivalent debit to the Tax authority. This amount is not debited from the purchaser of the property.¹⁷ In the leaseback transaction, if the lessee that transfers the property to the lessor for subsequent leasing does not use the purchase option, it shall pay in such debit.

Finally, reference is made to the breakdown and taxation of interests included in the leasing which are exempt when they are allocated to a house. Obviously, this is a transaction reserved to the real estate business linked to companies rather than homes.

VII. Conclusion.

The analysis of tax aspects involved in the transactions and the benefits thereof are defining the evident intention of not interfering with taxes, the generation and development of the business aimed at financing the construction industry and the sale of its products.

As already mentioned at the beginning of this comment, the element that will define the development of an economic activity is not that activity's tax treatment, but rather the political and economic condition. However, not interfering with taxes in decisions by brokers means having a clear vision of the company's overall objective. The multiplication effect of the construction industry will bring about and an increase in tax collection and an increase in the satisfaction of a social need such as housing.

17. VAT Law, section 11, paragraph 3.
